Information note:

Application of Concession Contracts

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Oifig um Sholáthar Rialtais
Office of Government Procurement

An Roinn Caiteachais Phoiblí agus Athchóirithe
Department of Public Expenditure and Reform

Contents

1. National Public Procurement Policy Framework

The National Public Procurement Policy Framework consists of 5 strands:

1) Legislation (Directives, Regulations)
2) Government Policy (Circulars etc.)
3) Capital Works Management Framework for Public Works
4) General Procurement Guidelines for Goods and Services
5) More detailed technical guidelines, template documentation and information notes as issued periodically by the Policy Unit of the OGP

The framework sets out the procurement procedures to be followed by Government Departments and State Bodies under national and EU rules. The framework supports contracting authorities, including the OGP, the four key sectors (Health, Education, Local Government and Defence), individual Departments, Offices, commercial and non-commercial State bodies, and private entities which are subsidised which are subsidised 50% or more by a public body, when awarding contracts for works, goods and services.

This information note on the application of Concession Contracts forms part of Strand 5 of the Framework. The note will be subject to amendment and review periodically and the most up to date version will be published on the Office of Government Procurement's website www.ogp.gov.ie. The note is not intended as legal advice or a legal interpretation of Irish or EU law on public procurement. Legal or other professional advice should be obtained if there is any doubt about the correct procedure to be followed.

2. Summary

In general, the new Concessions Directive is intended for large-scale, long-term, complex contracts predominately in infrastructural development with significant risk transfer, e.g. Public Private Partnerships.

3. Concession Contracts - Small "c" and Big "C"

In this note, the term "concession" represents the normal service type contract such as a canteen service at a facility while the term "Concession" refers to large scale - contracts covered by the new Concessions Directive.

- Small "c" = service type contracts
- Big "C" = elaborate investment arrangements through a Concession contracts format.

The new Directive 2014/23/EU has introduced a new procurement regime to cover the area of Concession contracts. This Directive aims at capturing and regulating activity across Europe in the form of large-scale, complex contracts forms that are more common in other Member States, predominately in infrastructural development, and which have not been readily open to market scrutiny heretofore.

The Directive, therefore, has a specific market scope and purpose in its form of regulation. Accordingly, the regime covers contract types which differ substantially from the norm of contract forms covered in the main Classic regime (Directive 2014/24/EU).

There has been some confusion in this area around the use of the word and term "concession" and there have been incidences of misunderstanding between the form of Concession covered by the Concessions Directive and the form of service contract which establishes a service "concession", the latter covered by the Classic Directive.

This note is intended as a guide to differentiating between these two very different categories of contract.

4. Concessions as Service Contracts [small "c"]

A concession or concession agreement, generally, is a grant of rights, by legal entity to an operator under licence, or other such instrument which grants access to a facility or other commercial opportunity wherein the licensee may carry out a business activity or provide a service under its own commercial direction.

The owner of a concession, the *concessionaire,* typically pays either a fixed sum or a percentage of revenue to the owner of the entity from which it operates. Examples of concessions within another business are concession stands within sporting venues and cinemas and concessions in department stores operating 'under the roof' of the principal retailer.

Larger scale operations could feature the provision of public services where it may be economically sound to contract out the particular service to a private sector operator which would provide the required service according to contractual arrangements.

Typically these concession forms, if they are above the services threshold, currently €135,000 for Central Government Sector and €209,000 for Local and Regional Authorities, fall to be procured as SERVICE Contracts under the Classic Directive.

They do <u>not</u>, appropriately, fall into the form of Concession Contracts covered by the Concessions Directive. It should be noted that an inappropriate application of the Concessions Directive rules to a public procurement could leave a Contracting Authority open to the risk of challenge on the basis that the incorrect regime has been applied to the procurement process.

The default, therefore, in all cases should be to consider the procurement of concessions as service contracts procured under the Classic regime.

5. Concessions Contracts – [Big "C"]

How do the characteristics of Concessive contracts differ from standard public contracts covering service-type concessions?

In short, Concession Contracts are high- value (above €5.2m), long-term (typically 20 years or more) complex and multi-dimensional contract forms, mainly in the infrastructural development market with elevated levels of commercial risk for the private sector operator standing in place of a public body in the provision of the requirement.

The main characteristics would include all or some of the following:

- **High-value contracts** – the threshold of €5.2m for concession contracts mirrors, predictably, the threshold for works contracts. However, in the market context of private sector financing it is likely that a critical mass for such contracts will lie at much higher values.
- **Long-term Duration** – the market norm for concessive contracts is driven by the appetite of private sector operators to corner a contract opportunity for a significant period of time. Hence, the market tends to support timespans in excess of 15 years with the duration of contract linked to return period on investment.
- **A right to use the constituent works or services** – this is a significant aspect which does not feature in standard public sector contracts apart from temporary responsibility transfers such as site management and attendant liability during works phases. A concessive contract implies a transfer of responsibility from the Contracting Authority (CA) to the Economic Operator (EO).
- **Often featuring a pro-tem transfer of title or ownership** – following from the previous point to reflect liability transfer, the title to the facility may transfer to the EO for the term of the contract with full reversion to the public body thereafter.
- **Consists of an investment rather than a trading activity** – this is a singular feature for concessive contracts given their scale and length; the funds come from a specific investment package rather than a project budget funded from trading liquidity.
- **Funding profile** – this differs from the regular payment schedule for a standard contract. For instance, on a 2 year construction project the contractor would receive payment upon completion of stages such as foundation level, shell and core, first fit-out, second fit-out etc. In a concessive contract, the contractor would not receive any payment from the CA until the entire works phase is completed. Classically, therefore in concessive contracts there is a lag in the profile of payments to the contractor and a continuation of payments over the lifetime of the concession period.
- **Special Purpose Vehicle (SPVs) or Joint Ventures (JVs) -** In that context, Special Purpose Vehicle (SPVs) or Joint Ventures (JVs) feature regularly in the contractual arrangements. Additionally, investment debt packages or debt instruments also feature.
- **Complex financial arrangements** and provisions for junior and senior debt allocation feature regularly.
- **Establishment of a contractual relationship** (formal or informal) between the EO and the User - as the EO stands in place of the CA for the duration of the contract, the

public service obligation transfers to the EO with attendant public realm scrutiny and accountability.

- **Transfer of risk to the EO -** i.e. either wholly or partially shared with CA/Contracting Entity (CE) – again a salient feature of a concessive contract.
- **Nett Present Value (NPV)** valuations common in costing and estimations
- **Provision for indexation of cost elements** – a common feature given the timespan; price variation clauses no longer feature in public sector contracts.
- **Operate and Maintain** – these elements a common feature in concessive contracts particularly where they underpin the return on investment.

6. Application of Concession Contracts

While the Concessions regime is designed to provide a flexible procurement model to match the dynamics of the concessive-type contract, it should be applied carefully and where it can be clearly demonstrated that the contract lies within the scope of concessive contracts and is distinct from the circumstances applying to standard public contracts.